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CHARLES E.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1929.

No. 93

NEW YORK LIFE INSURANCE COMPANY,
Petitioner,

against

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF THE STATE OF NEW YORK,
Respondent.

PETITION FOR WRIT OF CERTIORARI AND SUPPORTING BRIEF.

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The Evening Post Job Printing Office, Inc., 154 Fulton St., New York, N. Y.

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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1929.

No.

NEW YORK LIFE INSURANCE COMPANY,
Petitioner,

AGAINST

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

PETITION FOR A WRIT OF CERTIORARI.

TO THE HONORABLE, THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioner, New York Life Insurance Company, applies for a Writ of Certiorari to review a decision of the Circuit Court of Appeals for the Second Circuit affirming the judgment of the Trial Court, and says,—

Jurisdiction of the Court.

This application is made under and pursuant to Section 240 of the Judicial Code, as amended (43 Stat. 938). The judgment was entered March 10th, 1930 (R. 177).

Brief Statement of the Questions Involved.

FIRST: The Revenue Act of 1921 (Section 243) imposed a special income tax on life insurance for 1921 in lieu of the Capital Stock Tax. Notwithstanding this, was your petitioner liable for a Capital Stock Tax for the year ending June 30, 1921? The court held that it was.

SECOND: Section 1000 of the Revenue Act of 1918 imposed a Capital Stock Tax on mutual life insurance companies on the basis of the value of their assets over their liabilities, substantially as in *Hecht* v. *Malley,* 265 U. S. 144. In calculating the tax was the Commissioner justified,—

(a) In excluding from the liabilities side such deposits as the company was required by contract to hold for apportionment among and payment to its policyholders? and

(b) In excluding from the liabilities side dividends declared and paid to the policyholders during the current year?

THIRD: Does sub-section (b) of Section 1000 of the Revenue Act of 1918, which says that,—"In computing the tax in the case of insurance companies such deposits * * * as they are required by * * * contract to * * * hold for * * * payment to or apportionment among policyholders shall not be inclnded", apply only to stock life insurance companies and not to mutual life insurance companies?

FOURTH: Are deposits which life insurance companies are required by contract to hold for apportionment among and payment to policyholders "surplus or contingent reserves *maintained for the general use of the business*"?

FIFTH: Are dividends duly declared and payable during the year on the anniversary of each policy "surplus or contingent reserves *maintained for the general use of the business*"?

Brief Statement of the Facts.

1. This suit involves the Capital Stock Tax collected from the plaintiff under Section 1000 of the Revenue Act of 1918 for the years ending June 30, 1919, June 30, 1920, and June 30, 1921. The case was tried on an agreed statement of facts. Section 1000 is printed in full as an appendix to this petition and brief.

2. The petitioner is a mutual life insurance company transacting the business of life insurance on the mutual, level premium plan (R. 60).

3. The essence of mutual life insurance on the level premium plan is that each insured is entitled to receive and must receive his insurance at cost (R. 63).

4. An accounting made at the end of each year determines the excess in the premium over the actual cost and this excess belongs and is returned to the policyholders as their several policies require (R. 64, *et seq.*).

5. There are two plans for returning to policyholders the premiums they paid in excess of cost. One plan is called the annual dividend plan, the other the deferred dividend plan; but under each plan the insurance cost is exactly the same (R. 68, *et seq.*). These sums which the policyholders paid in excess of cost are not surplus or contingent reserves maintained for the general use of the business. They are sums which belong to the policyholders who paid them and which must be returned to those policyholders, not maintained for the general use of the business (R. 78, *et seq.*).

6. In *Hecht* v. *Malley*, 265 U. S. 144, the Commissioner, in assessing the Capital Stock Tax on a Massachusetts corporation that had no fixed share capital, determined the taxpayer's liability by ascertaining the value of the tax-

payer's assets in excess of its liability, and by imposing the Capital Stock Tax on the net sum so ascertained. This Court held that this was the proper way to impose the Capital Stock Tax on a corporation that had no fixed share capital. But in assessing the petitioner the Commissioner did not follow this rule. On the contrary, he threw out from the liabilities side of the petitioner's account each year the following three items,—

(1) Dividends declared on annual dividend policies;

(2) Dividends declared on deferred dividend policies; and

(3) Deposits which the plaintiff was required by its outstanding contracts to hold for apportionment among and payment to its stockholders.

7. To show specifically the way the Commissioner imposed the tax for each year, let us take as an illustration the exact way in which he calculated the tax for the year ending June 30, 1919, each other year being similarly calculated,—

"Every insurance company is required by law to file annually in each state where it transacts business, in the office of the Superintendent of Insurance or other corresponding state officer having supervision of insurance, a report showing among other things its income and disbursements for the preceding calendar year, which report must include a statement of its assets and liabilities.

"Such reports are required to be made upon uniform blank forms prepared by a committee of, and adopted by, the National Association of Insurance Commissioners, and known as 'Convention Edition forms'" (R. 73, *et seq.*).

The plaintiff duly filed this report each year on the form furnished it by the Superintendent of Insurance for that purpose (R. 73). In assessing the tax the Commissioner (R. 74, *et seq.*) took the amount of the plaintiff's admitted assets as shown by this annual report for the proper year and deducted

therefrom the difference between the book value and the market value thereof, and deducted also certain liabilities as shown thereby; but he did not deduct the excess in the premium over the actual cost of insurance which the plaintiff's contracts required it to return to the policyholders and which it duly declared as dividends and did return to them in accordance with the terms of their respective contracts, or the sum which it held for apportionment among and payment to them as their several contracts required. By failing to deduct these sums the Commissioner made the plaintiff appear to have a surplus or contingent reserve maintained for the general use of the business in the respective sums which formed the basis of the taxes in dispute.

For the year ending June 30, 1919, as shown by the Fifteenth paragraph of the agreed statement of facts (R. 74) and by Exhibit F (R. 126, *et seq.*), this calculation was as follows,—

Total admitted assets (line 47, R. 126).	$934,929,381.52
DEDUCTIONS (R. 74 and 127).	
(1). The difference between the book value and the market value of said admitted assets.....	$50,291,672.51
(2). The amount of legal reserves (R. 127) as shown by	
7. Net reserves (Paid —for basis).....	728,484,785.00
8. Extra reserve for total and permanent disability and accidental benefits.....	563,494.00
9. Present value of amounts not yet due on supplementary contracts not involving life contingencies	5,462,720.13

(3).	10. Present value of amounts incurred but not yet due for total and permanent disability benefits.....	213,892.00
	11. Liability on policies cancelled and not included in net reserve.	467,963.84
	12 to 20 inclusive. Unpaid policy claims..	10,350,318.67
	21. Due and unpaid on supplementary contracts *not* involving life contingencies	13,849.75
	22. Dividends left with the Company to acccrue at interest and accumulated interest thereon	2,180,726.52
	23. Premiums paid in advance, including surrender values so applied	1,093,413.43
	24. Unearned interest $3,129,273.54 and rent $7,607.38 paid in advance	3,136,880.92
	25. Commissions due agents on premium notes when paid.....	24,091.55
	26. Commissions to agents due or accrued..	9,632.41
	28. Salaries, rents, office expenses, bills and accounts due or accrued (including $3,350.72 accrued charges on deposits)	177,424.46
	29. Medical Examiner's fees $26,908.22; Inspector's fees $5,-	

736,90; and legal fees $4,719.96; due or accrued	37,365.08	
30. Estimated Amount hereafter payable for Fed., State and other taxes based upon the business of the year of this statement (including $41,370.75 accrued taxes on interest and deposits)	1,957,353.36	
34. Dividends or other profits due policyholders including those contingent on payment of outstanding and deferred premiums.....	1,741,222.65	
(4). Exemption	5,000.00	
Total Deductions.....		$810,429,008.03
Leaving a difference of.....		$124,500,373.49

Upon this difference the Commissioner assessed and collected a tax for the year ending June 30, 1919 of $124,500 (R. 74).

8. Liability items which the Commissioner did not deduct for the year ending June 30, 1919, or similar items for any year but should have deducted, were as follows (R. 127):

(1). Dividends declared on annual dividend policies (Line 35, Exhibit F, R. 127).	$12,437,514.00
(2). Dividends declared on deferred dividend policies (Line 36, Exhibit F, R. 127).	14,123.549.64
(3) Deposits which the petitioner was required by its contracts to hold for apportionment among and payment to its deferred dividend policyholders (Line 36, Exhibit F, R. 127).....	107,041,778.00

The opinion of the Circuit Court of Appeals (R. 165) is not yet reported. The opinion of the District Court (R. 43) is reported in 34 Fed. 2nd, 60.

Reasons Relied on for the Allowance of the Writ.

FIRST: The Court of Appeals has decided in this suit important questions of Federal law which have not been but which should be settled by this Court.

SECOND: The case involves questions of such public and general importance as require that a consideration and determination thereof should be made by this Court. Practically all life insurance corporations doing business in this country are interested in the decision of these questions. Some of them have suits pending, and all are looking forward to the final decision of this case for the settlement of their rights. No other suit involving these questions has been brought to trial, so far as petitioner knows.

THIRD: Notwithstanding Section 243 of the Revenue Act of 1921 provides "that in lieu of the taxes imposed by Section * * * 1000 (the Capital Stock Tax) * * * there shall be levied, collected and paid for the calendar year 1921, and for each taxable year thereafter, upon the net income of every life insurance company a tax as follows", and Section 200 defines the first taxable year as "the calendar year 1921 or *any fiscal year ending during the calendar year 1921*", the court erroneously held the petitioner liable for a Capital Stock Tax under Section 1000 for the year ending June 30, 1921.

FOURTH: The decision of the court is contrary to the decision of this Court in *Hecht* v. *Malley*, 265 U. S. 144.

FIFTH: Dividends declared were a fixed liability of the petitioner which could not be excluded in any statement based upon the assets and liabilities, and must be deducted in arriving at net assets.

SIXTH: Deposits which the petitioner was required by its policy contracts to hold for apportionment among and payment to a class of its policyholders were not, as the court held, surplus or contingent reserves maintained for the general use of the business, but were a specific liability of the petitioner payable to the class of policyholders for whom they were held; and also they were expressly excluded by sub-section (b) of Section 1000, which says,—"In computing the tax in the case of insurance companies, such deposits * * * as they are required by * * * contract * * * to hold for * * * payment to or apportionment among policyholders shall not be included."

SEVENTH: Sub-section (b) of Section 1000 of the capital Stock Tax of 1918 applies to all insurance companies without any limitation or qualification, and to limit it as the court did to insurance companies having a capital stock is not construction; it is amendment.

WHEREFORE, your petitioner respectively prays that a Writ of Certiorari issue to the United States Circuit Court of Appeals for the Second Circuit commanding said court to certify and send to this Court for its review and determination on a day certain to be named therein, a full and complete transcript of the record and all proceedings in said case, and that said judgment of the United States Circuit Court of Appeals for the Second Circuit may be reversed and a new trial granted, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem just; and your petitioner will ever pray.

NEW YORK LIFE INSURANCE COMPANY,
By JAMES H. MCINTOSH,
its Attorney.

SUPPORTING BRIEF.

I.

No Capital Stock Tax for the year ending June 30, 1921, because the Revenue Act of 1921, which took effect as to income taxes, as of January 1, 1921, imposed a special income tax upon life insurance for 1921 and thereafter in lieu of the Capital Stock Tax.

The Revenue Act of 1921 says,—"Section 263. This title (the income tax) shall take effect as of January 1, 1921."

Section 200 of the Revenue Act of 1921 says,—"The first taxable year to be called the taxable year 1921 shall be the calendar year 1921, *or any fiscal year ending during the calendar year 1921.*"

Section 243 of the Revenue Act of 1921 provides as follows,—

> "That in lieu of the taxes imposed by Sections 230 (the income tax on corporations generally) and 1000 (the capital stock tax) and by Title III, (war profits and excess profits tax) there shall be levied, collected and paid for the calendar year 1921 and for each taxable year thereafter, upon the net income of every life insurance company a tax as follows:"

And then the Act goes on to impose on life insurance a special income tax for 1921 and for each taxable year thereafter, which shall be in lieu of the capital stock tax and the other Federal taxes referred to.

Section 1400 of the Revenue Act of 1921 says,—

> *"In the case of any tax imposed by any part of the Revenue Act of 1918 repealed by this Act, if there is a tax imposed by this Act in lieu thereof, the provision*

imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act."

The corresponding tax under the Act of 1921, namely, the special income tax imposed on life insurance in lieu of the capital stock tax, took effect, under the provisions of the 1921 Act, January 1, 1921. Therefore, after January 1, 1921 there was no statute imposing a capital stock tax on life insurance.

II.

If a corporation had no capital stock, the 1918 Act taxed as capital stock the net value of its assets over its liabilities, and life insurance corporations were no exception to this rule.

1. Under the 1918 Act, the Commissioner assessed the Massachusetts Trusts on the net value of their assets over their liabilities, and this Court held that this was the correct way to assess them.

Hecht v. *Malley*, 265 U. S. 144.

In the syllabus in that case it is said,—"In the absence of a fixed share capital the capital stock is the net value of the property owned by the association and used in its business." And on page 163 MR. JUSTICE SANFORD, in delivering the opinion of the Court, said,—

> "We think that in the Act of 1918, in which the tax upon an association is based upon the average value of its 'capital stock', including surplus and undivided profits, these words are not to be given a technical meaning, but should be interpreted, in their entirety, and, in the absence of a fixed share capital, as equivalent to the capital invested in the business, that is, the net value of the property owned by the association and used in its business. As was said by the Circuit Court of Appeals,

the phrase in the Statute as to 'including surplus and undivided profits puts beyond doubt the question of the congressional intent to measure this tax by business and financial realities, not by bookkeeping forms or mere names.' And this construction is in harmony with the provision as to the excise tax on a foreign association, which is fixed upon the value 'of the capital actually invested in the transaction of its business in the United States'.

"We therefore conclude that the Crocker Association was also subject to the tax, and that this was properly *measured by the Collector by the net value of its property*—no question being made as to the correctness of his valuation."

The Department itself seemed to hold that the basis of the tax on a non-stock corporation was the difference between the value of its assets over its liabilities, because in an opinion by the Solicitor of Internal Revenue laying down rules for taxing mutual insurance companies under the 1918 Act, the Solicitor held,—

"2. In determining the amount of the assets upon which the capital stock is to be assessed, there should be deducted from the total assets the following amounts:

(1) The debt liabilities;

(2) The legal reserves;

(3) Such percentage of the amount of shrinkage from the total value of the assets to the market value of the assets as the amount of the assets in excess of the legal reserves bears to the total assets."

Internal Revenue Bulletin, Vol. 1, No. 18, May 1, 1922, p. 37.

2. Mutual life insurance corporations are no exception to this rule. On the contrary, the express language of the statute shows that this rule was intended. It imposes the tax upon "surplus or contingent reserves *maintained for the general use of the business.*"

What is meant by "surplus or contingent reserves maintained for the general use of the business."? It means the excess of the assets over liabilities. "Surplus or contingent reserves" is an expression which is well understood in the business of life insurance. It is precisely that sum representing the value of the assets in excess of the liabilities of the corporation which it maintains for the general use of the business and to meet unforeseen contingencies. If, therefore, in any given year the amount of the liabilities equals or exceeds the value of the assets, is that any reason why specific liabilities, like declared dividends and overpayments of premiums which are held awaiting apportionment among and payment to the policyholders who made the overpayments, should be thrown out from the liability side of the account in order to force a false and nonexistent surplus or contingent reserve on which to impose a tax?

Not merely is the decision of the court contrary to the rule laid down by this Court in *Hecht* v. *Malley* but it establishes a false surplus or contingent reserve for the purpose of imposing a capital stock tax on an imaginary capital valuation for the year ending June 30, 1919 in excess of $124,000,000, and a like imaginary capital valuation for each other year. Whoever heard of a life insurance corporation having a capital stock of any such value?

III.

Why should dividends declared, and the deposits the petitioner is required by its outstanding contracts to hold for apportionment among and payment to its policyholders, be excluded from the liability side of its account?

1. Dividends declared are such a well-known, fixed liability of the corporation that the subject will not admit of discussion before this Court.

2. In assessing this tax the Commissioner threw out from the liability side of the account Item 37 of the petitioner's annual report for the year ending December 31, 1917 (Exhibit F, R. 127),—

> "Amounts set apart, apportioned, provisionally ascertained, calculated, declared or held awaiting apportionment upon deferred dividend policies, not included in Item 36 ..... $107,041,778",

and a like Item 37, but less in amount, for each subsequent year (Exhibit G, R. 131, Exhibit H, R. 135, Exhibit I, R. 139).

(a) Exactly what was this important item that the Commissioner threw out of the liability side of the account?

"It is the essence of mutual insurance on the level premium plan that each policyholder is entitled to receive his insurance at cost; the company collecting its estimated, or level, premiums in advance and adjusting the actual cost afterwards when cost is known" (R. 63). At the end of each calendar year the petitioner takes an account of the business of the year and thereby ascertains the amount which each insured overpaid it for the year (R. 65), and accounts to each policyholder for the sum which he overpaid in the manner agreed to in his policy.

The petitioner has outstanding two classes of policies, one called the annual dividend class and the other the deferred dividend class (R. 68). To policyholders in the annual dividend class, the annually ascertained overpayments are paid back each year. To policyholders in the deferred dividend class, the annually ascertained overpayments, which are the same in amount (R. 68) "for each $1,000 of insurance on policyholders of the same age and insurance plan whether the policy is on the deferred or is on the annual dividend plan", is not annually returned to the policyholders, but these overpayments are (R. 70) "credited to the plaintiff's deferred dividend policyholders as a class", accumulated at interest and apportioned among and paid to the deferred dividend policyholders on the date named in their several contracts for making such payments.

This Item 37 which the Commissioner threw out from the liability side of the petitioner's account consists of the overpayments of premiums made by the petitioner's deferred dividend policyholders, which is thus held by the petitioner, as its policy contracts require, for apportionment among and payment to its deferred dividend policyholders on the several dates named for that purpose in their respective contracts.

(b) Are these overpayments of premiums, credited to the deferred dividend policyholders and held for apportionment among and payment to them respectively on the dates stated in their several contracts, surplus or contingent reserves *maintained for the general use of the business?*

Obviously they are not. They are sums derived from the deferred dividend policyholders only, that belong solely to the deferred dividend policyholders, that are held to the credit of the deferred dividend policyholers, which the petitioner's contracts require the petitioner to apportion among and pay to the deferred dividend policyholders. Other policyholders of the corporation have no interest whatever in them.

(c) This item should not have been thrown out of the liability side of the account not merely because it is a liability

but also because the statute plainly says it should not be. Section 1000 says,—

> "(b) In computing the tax in the case of insurance companies such deposits and reserve funds as they *are required by* law or *contract to* maintain or *hold for* the protection of or *payment to or apportionment among policyholders shall not be included.*"

(d) The learned Trial Court sustained the Commissioner in throwing out this item on the ground (R. 46) that subsection (b) applied to stock corporations only and not to mutual corporations. Why? The Act does not say so. The Act says,—"In computing the tax in the case of insurance companies", without any exception or word of limitation. No language could be more generic than the language here used.

The Trial Court, however, in order to reach the conclusion the Court reached, amends the Act. The Court grafts onto it an exception, a limitation, that is not there. By construction the Court gives the Act the meaning it would have if instead of saying what it so plainly says, it said,—In computing the tax in the case of insurance companies, *except mutual companies.* The Court cannot do this. It is amendment, not construction; a legislative, not a judicial, function.

Smietanke v. *First Trust & Savings Bank,* 257 U. S. 602;
Bate Refrigerator Co. v. *Sulzberger,* 157 U. S. 1;
Commr. of Immigration v. *Gottlieb,* 265 U. S. 310;
United States v. *Missouri Pacific,* 213 Fed. 169;
Atlantic Coast Line v. *United States,* 168 Fed. 175;
Lynch v. *Alworth-Stephens Company,* 294 Fed. 190;
Omaha Water Co. v. *City of Omaha,* 147 Fed. 1;
Wrightman v. *Boone County,* 88 Fed. 435.

(e) The argument of the Court of Appeals is hard to follow. I cannot understand from the Court's opinion whether the Court intended to follow the Trial Court or not,

and hold that sub-section (b) had no application to mutual insurance. Anyhow, the Court does not seem clearly to grasp the exact nature of the sum in question because the Court says (R. 169), "In these (mutual companies), though all the policyholders are collectively the debtor to each one, all are also members of the company and therefore collectively owners of any profits which it may make." But no one has any interest in the sum in question except the deferred dividend policyholders whose overpayments make it up. Anyhow, this sum is clearly a liability of the company and could not properly be excluded in any statement based upon assets and liabilities. And this is especially true where the statute expressly says as here,—"In computing the tax in the case of insurance companies such deposits * * * as they are required by * * * contract to hold for payment to or apportionment among policyholders shall not be included." A more exact description of the sum in question could not be made. Hence if a tax is assessed under this statute according to the terms of the statute, this sum could not be excluded from the petitioner's liabilities.

Conclusion.

This is a case, therefore, which this Court ought to review. Not merely because the petitioner has been taxed for a year in which Congress imposed another tax in lieu of the capital stock tax, but because the petitioner has been taxed on a fictitious capital stock valuation arising from the erroneous exclusion of liabilities, and because the decision of the Court is contrary to the decision of this Court in *Hecht* v. *Malley*, 265 U. S. 144.

Respectfully submitted,

JAMES H. MCINTOSH,
Counsel for Petitioner,
120 Broadway,
New York City.

24 April, 1930.

APPENDIX.

The Capital Stock Tax Law.

Section 1000 of the Revenue Act of 1918, is as follows,—

"SEC. 1000. (a) That on and after July 1, 1918, in lieu of the tax imposed by the first subdivision of Section 407 of the Revenue Act of 1916—

(1). Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000 of so much of the fair average value of its capital stock for the preceding year ending June thirtieth as is in excess of $5,000. In estimating the value of capital stock the surplus and undivided profits shall be included;

(2) Every foreign corporation shall pay annually a special excise tax with respect to carrying on or doing business in the United States, equivalent to $1 for each $1,000 of the average amount of capital employed in the transaction of its business in the United States during the preceding year ending June thirtieth.

(b) In computing the tax in the case of insurance companies such deposits and reserve funds as they are required by law or contract to maintain or hold for the protection of or payment to or apportionment among policyholders shall not be included.

(c) The taxes imposed by this section shall not apply in any year to any corporation which was not engaged in business (or in the case of a foreign corporation not engaged in business in the United States) during the preceding year ending June 30, nor to any corporation enumerated in Section 231. The taxes imposed by this section shall apply to mutual insurance companies, and in the case of every such domestic company the tax shall be equivalent to $1 for each $1,000 of the excess over $5,000 of the sum of its surplus or contingent reserves maintained for the general use of the business and any reserves the net additions to which are included in net income under the provisions of Title II, as of the close

of the preceding accounting period used by such company for purposes of making its income tax return; *Provided,* that in the case of a foreign Mutual Insurance Company the tax shall be equivalent to $1 for each $1,000 of the same proportion of the sum of such surplus and reserves, which the reserve fund upon business transacted within the United States is of the total reserve upon all business transacted, as of the close of the preceding accounting period used by such company for purposes of making its income tax return.

(d) Sec. 257 shall apply to all returns filed with the Commissioner for purposes of the tax imposed by this section."